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No. 85-1401

In the Supreme Court of the United States

OCTOBER TERM, 1985

TEMPLE UNIVERSITY, ETC., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether the court of appeals correctly held that petitioner was not entitled to a refund of Federal Insurance Contributions Act (FICA) taxes paid during 1979-1982 on amounts deducted from its employees' salaries and used to purchase tax-sheltered retirement annuities for those individuals.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A25) is reported at 769 F.2d 126. The opinion of the district court (Pet. App. A26-A31) is reported at 595 F. Supp. 94.

JURISDICTION

The judgment of the court of appeals (Pet. App. A35) was entered on July 22, 1985. A timely petition for rehearing was denied on September 24, 1985 (Pet. App. A34). On December 2, 1985, Justice Brennan extended the time within which to file a petition for a writ of certiorari to and including Feb-

ruary 21, 1986 (Pet. App. A33), and the petition was filed on that date. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner is a nonprofit educational institution exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code.[1] During 1979-1982, the taxable years at issue, petitioner operated a retirement annuity plan for its employees. Employees who chose to participate in this plan agreed to accept a salary reduction in a stated percentage of their compensation (Pet. App. A3). The amounts thus deducted from the employees' salaries, together with additional amounts contributed by petitioner, were used to purchase retirement annuities for the participating workers (*ibid.*). Under Section 403(b) of the Code, amounts deducted pursuant to salary reduction agreements from the pay of workers employed by charitable or educational organizations, and used to purchase retirement annuities, are not subject to current federal income tax. Rather, income tax is deferred until such time as the employees actually receive payments under the annuity contracts. See Pet. App. A3 & n.1. Because of this tax-deferral feature, these arrangements are commonly called "tax-sheltered" retirement annuities. See H.R. Rep. 98-432, 98th Cong., 2d Sess. 1658 (1984).

Section 3121(a) of the Code defines the term "wages" for purposes of the Federal Insurance Contributions Act (FICA or social security payroll) tax.

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[1] Unless otherwise noted, all statutory references are to the Internal Revenue Code of 1954 (26 U.S.C.), as amended (the Code or I.R.C.).

During the taxable years at issue, "wages" were defined generally to include "all remuneration for employment," but to exclude "the amount of any payment (including any amount paid by an employer for insurance or annuities * * *) made to, or on behalf of, an employee * * * on account of * * * retirement" (26 U.S.C. 3121(a)(2)(A)). In 1965, the IRS ruled that amounts withheld under salary reduction agreements and used to purchase tax-sheltered retirement annuities were "wages" within the meaning of this definition. Rev. Rul. 65-208, 1965-2 C.B. 383, 385. The Service reasoned that the words "amount paid by an employer for * * * annuities" as used in Section 3121(a)(2) should be construed to apply only in the situation "where an organization uses its own funds for the purchase of an annuity contract," as distinguished from the situation "where the employee takes a voluntary reduction in salary to provide the necessary funds" (1965-2 C.B. at 384-385). The Service accordingly concluded that salary reduction amounts used to purchase tax-sheltered annuities were "wages" subject to FICA tax, even though those amounts, pursuant to Section 403(b), were not currently includable in the employees' income for income tax purposes (1965-2 C.B. at 384-385).

During 1979-1982, the taxable years at issue, petitioner computed its FICA tax liability consistently with the principles set forth in Rev. Rul. 65-208. Petitioner accordingly treated the amounts withheld from its employees' pay under the salary reduction agreements as "wages" for purposes of Section 3121(a). Petitioner duly paid FICA taxes on the amounts so withheld (Pet. App. A3).

2. In 1981, this Court held in *Rowan Cos.* v. *United States*, 452 U.S. 247, that meals and lodging

provided for the convenience of the employer, the value of which was excludable from the recipient employees' income under Section 119, did not constitute "wages" for purposes of FICA tax (452 U.S. at 263). In the course of reaching that decision, the Court reasoned that the term "wages" as used in the Code's FICA provisions should generally be construed "to mean the same thing" (*id.* at 255) that it means in the Code's income-tax withholding provisions, where Congress has not explicitly provided otherwise. For many years prior to the *Rowan* decision, the IRS had taken the position that amounts withheld from employees' pay and used to purchase tax-sheltered retirement annuities did not constitute "wages" for income-tax withholding purposes. See I.R.C. § 3402; Rev. Rul. 65-209, 1965-2 C.B. 414 (amplifying Rev. Rul. 64-333, 1964-2 C.B. 114); Rev. Rul. 65-208, 1965-2 C.B. 383, 385. Based on this Court's reasoning in *Rowan*, therefore, petitioner in April 1983 filed timely claims for refund of that portion of its 1979-1982 FICA taxes that was attributable to its inclusion of the salary-reduction amounts in its employees' FICA wage base (Pet. App. A4, A27).

Following the denial of its administrative claims for refund, petitioner brought this refund suit in the United States District Court for the Eastern District of Pennsylvania. The district court granted summary judgment for the government, holding that petitioner was not entitled to a refund of FICA taxes for 1979-1982 (Pet. App. A26-A31). The court of appeals affirmed, one judge dissenting (*id.* at A1-A25).

ARGUMENT

The decision below is correct. Petitioner does not allege, nor is there, a conflict among the circuits on the substantive question of tax law presented. That question has no prospective importance, since it cannot arise for any taxable year after 1983. There is no basis for further review.

1. The court of appeals carefully analyzed the history of the IRS's administrative interpretation of Section 3121(a)(2)(A) and the actions that Congress took in 1983 and 1984 in response to this Court's *Rowan* decision. Based on that analysis, the court of appeals correctly held that funds used to purchase tax-sheltered retirement annuities, if provided by salary reduction agreements voluntarily entered into by employees, did not constitute "amount[s] paid by an employer for * * * annuities * * * on account of * * * retirement" within the meaning of Section 3121(a)(2)(A) as it existed prior to 1984.

a. As the court of appeals explained (Pet. App. A5-A8), the IRS first addressed the question presented in 1965. In Rev. Rul. 65-208, the Service held that, in determining the application of Section 3121(a)(2)(A), it was appropriate to distinguish between situations in which "an [employer] uses its own funds for the purchase of an annuity contract" and situations in which "the employee takes a voluntary reduction in salary to provide the necessary funds." 1965-2 C.B. at 385. Compare Rev. Rul. 181, 1953-2 C.B. 111 (holding that funds used to purchase retirement annuities are excludable from the FICA wage base when the employer uses its own funds). In thus distinguishing the two situations, the Service made a reasonable construction of the statute. While all of an employee's compensation emanates from his

employer in an ultimate sense, it was appropriate for the Service, in the case of salary reduction agreements, to regard the employee rather than the employer as the *proximate* source of the funds used to purchase the annuities, and hence to conclude that those funds were not "amount[s] paid by [the] employer" within the meaning of Section 3121(a)(2).

The reasonableness of the Service's 1965 construction of the statute is shown by its consistency both with common sense (Pet. App. A7) and with overriding legislative policy. Because "FICA taxes fund a national system of social insurance that supports important and extensive social security and medicare health programs," it was appropriate for the IRS to construe Section 3121(a)(2)(A) in a manner that reflected "the long-standing congressional intent to restrict the forms of compensation excluded from the FICA wage base" (Pet. App. A7, A6). As Congress noted in 1983, if individuals were free to immunize their salaries from FICA tax by entering into voluntary salary reduction agreements of the sort involved here, they "could, in effect, control which portion of their compensation was to be included in the social security wage base," a result that "would make the system partially elective and would undermine the FICA tax." S. Rep. 98-23, 98th Cong., 1st Sess. 40 (1983).

As the court of appeals noted (Pet. App. A5), the IRS consistently followed the construction of the statute set forth in Rev. Rul. 65-208 from 1965 until Section 3121(a) was amended in 1983. During that 18-year period, the ruling was not questioned in any reported judicial decision, nor was it challenged in litigation by petitioner or by any other taxpayer. Indeed, petitioner itself "conformed to [Rev. Rul. 65-

208] in making its reports and paying its FICA taxes quarter-annually year after year, including for a significant period after the *Rowan* decision" (Pet. App. A17 (emphasis omitted)). This longstanding administrative construction of the statute, concurred in with apparent unanimity by taxpayers and their advisors nationwide, is entitled to considerable deference.

In 1983, Congress became aware of the possible implications of the *Rowan* decision upon the proper construction of Section 3121. Congress accordingly amended the statute for the explicit purpose of clarifying the law. Social Security Amendments of 1983, Pub. L. No. 98-21, § 324(a)(2) and (3), 97 Stat. 122-123. This amendment was accomplished by adding to the Code a new Section 3121(a)(5)(E), which defines "wages" for FICA purposes to exclude amounts paid under "an annuity contract described in section 403(b), *other than a payment for the purchase of such contract which is made by reason of a salary reduction agreement*" (Pub. L. No. 98-21, § 324(a)(2)(C), 97 Stat. 122 (emphasis added) (now codified in I.R.C. § 3121(a)(5)(E)). The legislative history of this 1983 amendment shows that "Congress saw Rev. Rul. 65-208 as the properly applicable law" during years prior to 1984 and believed that it was "merely codifying the prior law as articulated in Rev. Rul. 65-208" (Pet. App. A6). As the Senate report stated (S. Rep. 98-23, *supra*, at 41):

> The bill also provides that any amounts paid by an employer to a tax-sheltered annuity by reason of a salary reduction agreement between the employer and the employee would be includible in the employee's social security wage base. The committee intended that the provision would

merely codify the holding of Revenue Ruling 65-208.

b. Based upon the IRS's consistent and unchallenged interpretation of the statute over an 18-year period, and upon the legislative history of the 1983 amendment, the court of appeals correctly held (Pet. App. A5-A8) that salary reduction amounts used to purchase tax-sheltered annuities are not "amount[s] paid by an employer for * * * annuities * * * on account of * * * retirement" within the meaning of former Section 3121(a)(2)(A), and hence that such amounts were properly includable in the FICA wage base during the 1979-1982 tax years at issue. And that is so despite this Court's 1981 *Rowan* decision. While the broad reasoning of that opinion "obviously helps the plaintiff here" (Pet. App. A14), that decision did not directly affect the proper construction of Section 3121(a)(2)(A). The holding of *Rowan* was merely that the value of meals and lodging furnished to employees for the convenience of the employer is excludable from the FICA wage base (452 U.S. at 263). In reaching that holding, the Court relied extensively on legislative history, Treasury Regulations, and IRS rulings concerning the historical tax treatment of employer-furnished "supper money," "room and board," and similar items. See 452 U.S. at 257-262. The Court noted that "the Service itself was inconsistent in construing the term 'wages' " in the meals-and-lodging context (*id.* at 261). The Court in *Rowan* had no occasion to consider whether salary reduction amounts used to purchase tax-sheltered retirement annuities constitute "wages" for FICA purposes—such amounts, unlike the meals and lodging at issue in *Rowan*, qualify only for income tax deferral rather than for a permanent income tax exemp-

tion—nor did the Court in *Rowan* have before it the consistent and unchallenged course of administrative construction that is present here.

Even if there were some question whether the court of appeals erred in its construction of now-repealed Section 3121(a)(2)(A), it would not be a question meriting this Court's review. As petitioner appears to concede (Pet. 12-14), there is no conflict among the circuits on the substantive question of tax law presented. To the contrary, the Third Circuit below was the first court of appeals to consider whether salary reduction amounts used to purchase tax-sheltered annuities constitute "wages" for FICA purposes. Every district court that has since considered that question has explicitly followed the decision below. See *University Health Center, Inc.* v. *United States*, 622 F. Supp. 88, 89 (D. Vt. 1985); *Xavier University* v. *United States*, No. C-84-1151 (S.D. Ohio Mar. 7, 1986); *Canisius College* v. *United States*, No. 84-1126E (E.D.N.Y. Mar. 10, 1986); *New England Baptist Hospital* v. *United States*, No. 84-1592-Mc (D. Mass. May 7, 1986). The question presented has no prospective importance, since it cannot arise for any tax year after 1983. There is thus no basis for further review.[2]

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[2] While appearing to concede the absence of a circuit conflict on the substantive question of tax law presented, petitioner urges this Court to resolve an asserted "conflict in the circuits regarding the precedential weight of [IRS] revenue rulings" (Pet. 12). Petitioner notes that revenue rulings represent the official opinion of the IRS and lack the legal force of Treasury Regulations, and asserts that the court of appeals' "unprecedented grant of authority to a revenue ruling creates a direct conflict with other circuits" (Pet. 13). This assertion is doubly flawed. In construing Section 3121(a)(2)(A) as it did, the court of appeals did not rely solely upon the *promulgation* of Rev. Rul. 65-208. The court relied

2. Petitioner also asks this Court to review the court of appeals' alternative holding (Pet. App. A13-A17) that, if the *Rowan* decision were viewed as having changed the law on the question presented, Congress has barred refund claims like petitioner's retroactively, and that this retroactivity does not offend the Due Process Clause. See Pet. i, 16-18. There is, however, no need for the Court to reach the retroactivity question in this case. As we have explained, the court of appeals' construction of unamended Section 3121(a)(2)(A), as to which there is no conflict in the circuits, and which reflects Congress's own view of the pre-1984 law, represents a nonconstitutional ground of decision that is fully adequate to support the judgment below.

In any event, petitioner's constitutional argument is insubstantial. As the court of appeals explained (Pet. App. A10-A11), Congress acted in 1983 to change certain aspects of this Court's decision in *Rowan*. While codifying the Court's narrow holding respecting exclusion of meals and lodging from the

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as well on the facts that the IRS had administered the tax laws for 18 years consistently with the interpretation set forth in that ruling; that the IRS's construction of the statute was shared with apparent unanimity by the Nation's taxpayers and their advisers, including petitioner itself; that Congress in 1983 had explicitly indicated its view that Rev. Rul. 65-208 accurately stated the law under the unamended statute; and that the construction of the statute set forth in Rev. Rul. 65-208 was reasonable on its face, being consistent both with common sense and legislative policy. And even if petitioner could demonstrate some conflict in reasoning or principle as to the weight to be accorded revenue rulings in general, that theoretical disagreement would not indicate that any other circuit would have reached a contrary conclusion with respect to the particular question presented here. Nor would it otherwise represent a conflict among the circuits requiring resolution by this Court. See Sup. Ct. R. 17.1(a).

FICA tax base (Pub. L. No. 98-21, § 327(a)(1), 97 Stat. 126-127 (now codified at I.R.C. § 3121(a)(19)), Congress rejected the Court's broader reasoning that "wages" should generally be construed to mean the same thing for FICA and income-tax-withholding purposes. Pub. L. No. 98-21, § 327(b)(1), 97 Stat. 127 (now codified at I.R.C. § 3121(a) (penultimate sentence)). The latter amendment is commonly called "the *Rowan* decoupling provision" (Pet. App. A9-A10). Both amendments were originally made effective prospectively only, that is, for "remuneration paid after December 31, 1983" (Pub. L. No. 98-21, § 327(d)(1), 97 Stat. 127). Congress's choice of a prospective-only effective date is most naturally explained as reflecting its belief that retroactive application of the 1983 amendments was unnecessary because Rev. Rul. 65-208 accurately stated prior law. See Pet. App. A6-A8, A9 n.3.

In 1984, Congress further evidenced its belief that Rev. Rul. 65-208 accurately stated prior law by amending the effective date of the *Rowan* decoupling provision to ensure that taxpayers did not file refund claims "based on the rationale of *Rowan*, i.e., that 'wages' for FICA purposes are presumptively the same as 'wages' for income tax withholding purposes" (Pet. App. A10). See Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 2662(g), 98 Stat. 1160 (amending Pub. L. No. 98-21, § 327(d), 97 Stat. 127). The 1984 amendment provided that the *Rowan* decoupling provision was to apply to remuneration "paid after March 4, 1983, *and to any such remuneration paid on or before such date which the employer treated as wages when paid*" (Pub. L. No. 98-369, § 2662(g), 98 Stat. 1160 (emphasis added)).

Congress explained this amendment by emphasizing the disruption in the administration of the tax laws, from the viewpoints both of the government and of social security recipients, that negative inferences from the original prospective-only effective date might produce. As the House Report stated (H.R. Rep. 98-432, 98th Cong., 2d Sess. 1658 (1984) (footnote omitted)):

> [I]t is possible that [the prospective-only effective date in the 1983 law] could be cited as demonstrating Congressional intent that the reasoning of the *Rowan* decision should generally apply before these dates to types of remuneration other than meals and lodging * * * e.g., to contributions under a salary reduction agreement to tax-sheltered annuities (sec. 403(b)). These contributions have been held by the Treasury Department to be taxable for FICA purposes (Revenue Ruling 65-208) even though they are exempt by regulation from income tax withholding. If the 1965 revenue ruling were determined to be invalid, then employers and employees would be eligible for tax refunds for open years because taxable wages would be lower. In addition, wages for benefit computation purposes would be reduced, leading in some cases to reduction of social security benefits being paid to current beneficiaries and recoupment of a portion of benefits which have been paid in recent years on the basis of wage records which included the salary reduction contributions.

In order to avoid such erroneous and disruptive inferences, Congress "clarifie[d] the effective date of the provision overriding the *Rowan* decision" so as to preclude refund claims of the sort filed by petitioner here (H.R. Rep. 98-432, *supra*, at 1658).

The court of appeals correctly rejected the contention that petitioner was unconstitutionally subjected to retroactive application of the *Rowan* decoupling provision. To begin with, this Court has often held that a statute which merely clarifies existing law, as Congress stated that the challenged amendments were designed to do, is not "retroactive" at all in the constitutional sense. *Commissioner* v. *Wheeler*, 324 U.S. 542, 545 (1945); *Commissioner* v. *Fisher*, 327 U.S. 512, 514-515 (1946). Even if those amendments were thought to have changed the law retroactively, this Court has repeatedly upheld the retroactive application of income tax laws, both where the period retroactively covered is in the same calendar year as the year of enactment and where it is an earlier calendar year. See, *e.g.*, *United States* v. *Darusmont*, 449 U.S. 292, 296, 297-301 (1981) (per curiam) (citing cases).[3] In order to prevail on a constitutional challenge, a taxpayer must show that the retroactive

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[3] Contrary to petitioner's suggestion (Pet. 17-18 & n.18), this case has virtually nothing in common with *United States* v. *Hemme*, appeal pending, No. 84-1944. That case involves a due process challenge to an allegedly retroactive provision of the federal estate tax laws. The district court in that case had acknowledged that "Congress may provide for the retroactive operation of income tax legislation" (84-1944 J.S. App. 3a) but had held, on the supposed authority of *Untermyer* v. *Anderson*, 276 U.S. 440 (1928), that "the justification for upholding retroactive income tax legislation does not apply to estate and gift tax [laws]" (84-1944 J.S. App. 3a). Although we have demonstrated that the latter proposition is erroneous (84-1944 U.S. Br. 21-24), the fact that the instant case involves the income tax rather than the estate tax removes any need to hold this case pending disposition in *Hemme*, particularly since there exists a fully adequate, independent nonconstitutional ground of decision here.

application of a particular tax "is so harsh and oppressive as to be a denial of due process." *Id.* at 299. Accord, *e.g.*, *Welch* v. *Henry*, 305 U.S. 134, 147 (1938). It is well settled that "[t]he retroactive aspects of legislation * * * meet the test of due process * * * simply [upon a] showing that the retroactive application of the legislation is itself justified by a rational legislative purpose." *Pension Benefit Guaranty Corp.* v. *R.A. Gray & Co.*, 467 U.S. 717, 730 (1984).

Judged by these standards, petitioner's constitutional argument is plainly insubstantial. The challenged 1984 amendment was a "curative" provision (Pet. App. A15) designed to "avert[] the potentially disruptive effect of the *Rowan* decision on the multitude of transactions properly reported by taxpayers in accordance with the applicable rule of law at the time" (*id.* at A17). Indeed, Congress recognized in 1984 that a decision to allow tax refunds of the type sought by petitioner would raise as many retroactivity problems as would a decision to deny such refunds, since the other side of the former coin would be possible "reduction of social security benefits being paid to current beneficiaries and recoupment of a portion of benefits which have been paid in recent years on the basis of wage records which included the salary reduction contributions" (H.R. Rep. 98-432, *supra*, at 1658). Congress surely had a "rational legislative purpose" (*Pension Benefit Guaranty Corp.*, 467 U.S. at 730) in acting to validate a statutory interpretation relied on for 18 years by a multitude of persons, including employers and employees of a wide variety of nonprofit institutions and millions of past, present and future recipients of social security.

Finally, it could not plausibly be contended that retroactive application of the *Rowan* decoupling provision would be "so harsh and oppressive as to be a denial of due process" (*United States* v. *Darusmont*, 449 U.S. at 299). The 1984 change in effective dates imposed no new or unanticipated tax liability upon petitioner. To the contrary, it simply preserved a tax practice that had been universally followed for many years by petitioner and others. In validating that practice, the 1984 amendment did no more than deprive petitioner of the possibility of garnering an undeserved windfall, in the form of potential tax refund claims, from an interpretation of the *Rowan* decision that Congress believed to be incorrect. It would have been far more "harsh and oppressive" if the court of appeals had accepted petitioner's invitation to declare the 1984 amendment unconstitutional, thereby jeopardizing the social security benefits of numerous individuals.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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